



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 6, 2001

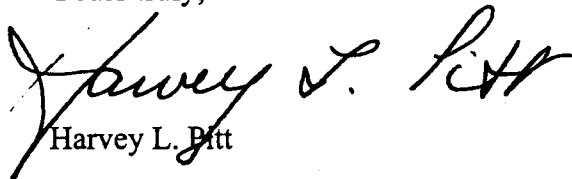
The Honorable John D. Dingell
Ranking Member
Committee on Energy and Commerce
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515-6115

Dear Congressman Dingell:

In September 1998, you asked the Commission to provide you with annual progress reports, through the year 2003, on SEC and industry initiatives to improve corporate bond transparency. Today, I am pleased to provide this fourth in a series of annual reports, prepared by the Division of Market Regulation.

Please do not hesitate to call me at (202) 942-0100 or Annette Nazareth, Director of the Division of Market Regulation, at (202) 942-0090 if we can be of further assistance.

Yours truly,

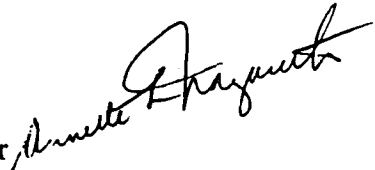

Harvey L. Pitt

Enclosure

cc: The Honorable W.J. "Billy" Tauzin
The Honorable Michael G. Oxley
The Honorable John J. LaFalce

MEMORANDUM

TO: Chairman Pitt

FROM: Annette L. Nazareth, Director 
Division of Market Regulation

RE: Corporate Bond Transparency

DATE: December 4, 2001

In September 1998, Congressman John D. Dingell asked the Commission to submit annual progress reports to the House Committee on Energy and Commerce regarding corporate bond transparency. These reports, to be provided through the year 2003, are to contain a discussion of regulatory and industry initiatives in this area to permit the Committee to determine how much progress has been made. This memorandum summarizes developments during the past year regarding the National Association of Securities Dealers, Inc.'s ("NASD") TRACE proposal and the operation of alternative trading systems under Regulation ATS under the Securities Exchange Act of 1934 ("Act").

1. NASD's TRACE Proposal

As we reported last year, in October 1999, the NASD filed with the Commission a proposal to require NASD members to report the transaction information on most U.S. corporate bonds to the NASD, and to establish a facility, called "TRACE," to accommodate this mandatory reporting. The TRACE proposal also included a timeline for public dissemination of that transaction information. The Commission received 39 comment letters in response to its publication of the TRACE proposal. Although the comment letters generally supported enhanced price transparency in the corporate debt markets, they raised a number of specific concerns. The principal concerns related to potential negative effects on liquidity and the role of Nasdaq as an exclusive processor of bond data given its announced intention to become a privatized, for-profit exchange.

The NASD subsequently amended the TRACE proposal to address the concerns raised by the commenters. In particular, the NASD designated itself as owner and operator of TRACE, removing TRACE from the control of Nasdaq. In addition, the NASD proposed a phase-in schedule for dissemination of transaction information to permit dissemination of information relating to bonds with the largest issuance to begin immediately and allow bonds with a smaller issuance size to be phased-in later. On January 23, 2001, the Commission approved the amended TRACE proposal.¹

¹ Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) ("Approval Order").

As approved, the amended TRACE rules were to be implemented 180 days after the date the NASD provided technical specifications to its members.² The NASD published its specifications on June 1, 2001; accordingly, the TRACE rules would have been implemented on December 1, 2001 under the schedule contemplated in the Approval Order. Prior to the events of September 11, 2001, however, the NASD decided to delay the effective date and implementation of TRACE until February 1, 2002 in order for the industry to better prepare for TRACE reporting. In light of the events of September 11, the NASD subsequently announced that it would delay TRACE implementation until July 1, 2002 to allow its members to re-establish, to the extent possible, normal business operations. The NASD also announced that it would conduct testing from February through June 2002. We will continue to consult with NASD technical staff on their progress in implementing TRACE.

2. Alternative Trading Systems

Another development that may affect transparency of the debt market is the increase in the number of alternative trading systems available to trade debt instruments. In last year's report, we stated that 34 systems (out of a total of 66 systems that filed Form ATS) traded some type of debt security, an increase of 127% over the previous year. Today, 42 systems out of a total of 69 that have filed Form ATS trade some type of debt security. Thus, the number of debt trading systems has increased by roughly 23% since last year. While not as impressive as the increase of 127% witnessed in the previous year, the 23% increase during the past year illustrates the growing role of debt trading systems in our markets.

We have witnessed growth not only in the number of debt systems, but also in the different types of debt instruments traded through these systems. For example, we are seeing more systems that trade municipal and, to a lesser extent, government securities. Overall, however, the relative trading volume of these systems continues to remain low.

² Id.